

**Comments on the proposed rule: *Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations*, issued by the Board of Governors of the Federal Reserve System**

Japanese Bankers Association

We, the Japanese Bankers Association (“JBA”), would like to express our gratitude for this opportunity to comment on the proposed rule: *Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations*, issued on October 30, 2015 by the Board of Governors of the Federal Reserve System (the “Board”).

We respectfully expect that the following comments will contribute to your further discussion.

**[General Comments]**

While we understand the objective and intent of the proposed rule, the Board is requested to ensure a regulatory framework that is consistent with the international total loss-absorbing capacity (“TLAC”) standard released by the Financial Stability Board (“FSB”). It is critical to achieve regulatory harmonization between the home and host jurisdictions in order to ensure that TLAC will contribute to a smooth cross-border resolution proceeding in accordance with the intent of the TLAC standard.

As explained in detail in our comments to specific questions provided hereinafter, consistency with the FSB’s TLAC standard should be ensured particularly in such areas as long-term debt (“LTD”) requirements, haircuts applied to LTD, requirements for eligible internal TLAC instruments and entities to which they are issued, and the timing of implementation.

**[Comments to questions]**

**Question 19 (Requirements for eligible external LTD (Haircut))**

The Board invites comment on whether the proposed treatment of eligible external LTD with a remaining maturity of less than two years is appropriate. How would a different remaining maturity requirement or amortization schedule better achieve the objectives of the proposal?

(Our comment)

- Instead of assigning a 50% haircut, long term debt (LTD) with a remaining maturity between one and two years should be counted toward the external LTD requirement in full.

(Basis, etc.)

- The proposed rule applies the 50% haircut on the ground that, in the case of covered bank holding companies (BHCs), they may lose loss-absorbing capacity if the eligible external LTD matures during the period between the time when they begin to experience extreme stress and the time when they enter a resolution process. In the case of covered intermediate holding companies (IHCs) of foreign banking organizations (FBOs), however, the 50% haircut should be unnecessary because if they issue internal LTD to their parent entity, the parent company is likely to refinance the debt necessary for loss absorbing even when the internal LTD matures during the period between the time when they begin to experience extreme stress and the time when they enter a resolution process.

**Question 25 (Scope of application of internal TLAC/LTD requirements)**

The Board invites comment on alternative approaches for determining the scope of application of the proposed internal TLAC and LTD requirements. Should the Board apply the proposed internal TLAC and LTD requirements to all U.S. intermediate holding companies required to be formed under the IHC rule rather than limiting it to U.S. intermediate holding companies that are controlled by foreign GSIBs?

(Our comment)

- The scope of application should be determined in consultation with the home authorities and pursuant to the FSB'S TLAC standard, based on the 5% criteria and identification by the Crisis Management Group ("CMG"), etc.

(Basis, etc.)

- Given that one of the key objectives of the TLAC standard is to ensure the

continuity of critical functions in an orderly resolution, it is unreasonable to include those entities that do not meet the quantitative criteria and that do not have critical functions. In addition, such an approach would undermine loss-absorbing capacity of material subsidiaries which should hold sufficient internal TLAC.

**Questions 28 & 31 (TLAC/LTD requirements for IHCs)**

The Board invites comment on all aspects of the proposed calibration of the internal TLAC and LTD requirements, including any impact on the internal funding structures of the covered IHC's parent foreign bank.

The Board invites comment on whether to eliminate the proposed internal TLAC requirement and subject covered IHCs to the proposed internal LTD requirement only.

**(Our comment)**

- The proposed internal LTD requirement needs not be introduced.
- The calibration of the internal TLAC should be determined pursuant to the FSB standard and in consultation with the home authorities.

**(Basis, etc.)**

- The debt instruments would generally be converted to equity in case of a resolution, and not directly absorb losses as would equity. Therefore, capital has better loss-absorbing capacity than debt instruments. Imposing the internal LTD requirement under the internal TLAC requirement would disincentivise firms from maintaining a high capital adequacy ratio. Therefore, such requirement would rather lead to undermining of the stability of financial institutions.

**Questions 32 & 34 (Requirements for eligible internal TLAC/LTD)**

The Board invites comment on all aspects of the proposed definition of eligible internal TLAC.

The Board invites comment on the appropriateness of subjecting eligible internal LTD to the same requirements as apply to eligible external LTD.

**(Our comment and basis, etc.)**

- The Board should reconsider the requirements for the eligible internal TLAC/LTD.
- Firstly, it is necessary to harmonise the home jurisdiction's regulation and the host jurisdiction's regulation in order to secure the total loss-absorbing capacity at a level that facilitates smooth cross-border resolution. Therefore, the eligibility requirements would need to be aligned with the FSB's TLAC standard in principle, and hence collateralized guarantees, which are regarded as eligible liability in the

FSB's TLAC standard, should be included as eligible internal LTD.

- Secondly, for the same reason as the first point, triggers for write-off and conversion of internal LTD should ensure consistency with the global framework of cross-border resolution currently being discussed. Additionally, triggers should be based on the legal system and resolution scheme in home country, and hence a framework should be designed to determine triggers based on discussions with the home authorities.
- Thirdly, insofar as clean holding company requirements are satisfied, a contractual subordination requirement should be unnecessary because senior debt issued by IHCs will be structurally subordinated to others.
- Finally, the Board is requested to allow grandfathering in relation to those debts already issued. Unless grandfathering is allowed to some extent, banks will have to raise funds unnecessarily in addition to existing debts issued.

Question 33 (Requirements for eligible internal LTD (Haircut allocated in the case of a remaining maturity between one and two years))

Should eligible internal LTD with a remaining maturity between one and two years be subject to a 50 percent haircut for purposes of the internal TLAC requirement, by analogy to the treatment of such eligible internal LTD for purposes of the internal LTD requirement?

(Our comment)

- Instead of applying a 50% haircut, the full value of internal LTD with a remaining maturity between one and two years should be counted toward eligible liabilities for purposes of the internal TLAC requirement.

(Basis, etc.)

- The proposed rule applies the 50% haircut on the ground that, in the case of covered BHCs, they may lose loss-absorbing capacity if the eligible external LTD matures during the period between the time when they begin to experience extreme stress and the time when they enter a resolution process. In the case of covered IHCs of FBOs, however, the 50% haircut should be unnecessary because if they issue internal LTD to their parent entity, the parent company is likely to refinance the debt necessary for loss absorbing even when the internal LTD matures during the period between the time when they begin to experience extreme stress and the time when they enter a resolution process.

**Question 35 (Requirement for eligible internal LTD (Governing law))**

The Board invites comment on the requirement that eligible internal LTD instruments be governed by U.S. law. Is this requirement adequate to ensure that losses can be imposed on such instruments under the U.S. Bankruptcy Code or Title II without undue legal risk? Are additional requirements appropriate? In particular, would a requirement that such instruments be subject to the contract law of one or more States be appropriate? Is it appropriate to permit such instruments to be governed by non-U.S. laws in any respects?

(Our comment)

- The governing law requirement should be determined in consultation with home authorities of G-SIBs.

(Basis, etc.)

- The TLAC standard deems the issuer of external TLAC as a resolution entity. It is therefore assumed that resolution will be entered into in accordance with the resolution regime in the jurisdiction where the ultimate parent entity is located if the resolution is based on a single-point-of-entry (“SPOE”) strategy. In this view, from the perspective of ensuring feasibility of the resolution, the governing law should be determined in consultation with home authorities of G-SIBs.

**Question 36 (Requirement for eligible internal LTD (Entity to which LTD is issued))**

The Board invites comment on all aspects of the requirement that eligible internal LTD be issued to a foreign parent entity that controls the covered IHC. In particular, the Board invites comment with respect to whether covered IHCs that are expected to enter resolution themselves in a failure scenario should be permitted to issue eligible internal LTD to third parties, as covered BHCs would. Should internal LTD be required to be issued to the top-tier foreign parent of the covered IHC?

(Our comment)

- The Board is requested to include unsecured debt issued to some third-party investors in eligible internal LTD to the extent that the control status of the parent entity remains unchanged.

(Basis, etc.)

- Given the intent of TLAC (i.e. to ensure the continuity of critical functions of financial institutions without causing impacts on financial stability and without exposing public funds to loss in resolution), there should be no issue in deeming not only unsecured corporate bonds issued to a parent entity but also unsecured

corporate bonds which are recognized as having loss-absorbing capacity and issued to third-party investors as eligible TLAC and LTD.

- If the control status remains unchanged after the loss absorption, the resolution entity continues to be committed to the material subsidiary.
- This treatment is not consistent with the basic policy of *the Interagency Policy Statement on Funding and Liquidity Risk Management* issued in March 2010 by the U.S. banking agencies (i.e. the Board, the Office of the Comptroller of the Currency (“OCC”), the Federal Deposit Insurance Corporation (“FDIC”), the Office of Thrift Supervision (“OTS”), the National Credit Union Administration (“NCUA”), and the Conference of State Bank Supervisors (“CSBS”)), which is to ensure diversification of funding sources.

**Question 38 (Requirement for eligible internal LTD (Contractual requirement))**

The Board invites comment on all aspects of the contractual conversion trigger requirement, including the appropriateness of the requirement for foreign GSIBs with SPOE and MPOE resolution strategies, whether an alternative to the “in default or in danger of default” standard would be more appropriate, and any legal risks associated with the Board's conversion of eligible internal LTD into equity in order to recapitalize the covered IHC.

(Our comment)

- Conversion to equity (the trigger event) should be determined based not only on the judgment of U.S. authorities but also in consultation with home authorities in order to promote a smooth cross-border resolution proceeding.

(Basis, etc.)

- Conversion to equity (the trigger event) by U.S. authorities may undermine cross-border resolution action by home authorities.

Question 71 (Timing of implementation)

The Board invites comments on all aspects of the transition period, including whether the proposed phase-in period for the risk-weighted assets components of the proposed external and internal TLAC requirements is appropriate. Would it be appropriate to instead require compliance with those higher requirements as of January 1, 2019?

(Our comment)

The requirements other than the risk-weighted assets (“RWA”) component of the internal TLAC requirement should also be subject to phase-in implementation.

(Basis, etc.)

- Under the FSB standard, since TLAC Leverage Ratio Exposure Minimum Requirement as well as the TLAC RWA Minimum Requirement will be phase-in, in practice, firms will issue TLAC instruments targeting 2019 and 2022 in order to meet respective minimum requirements. Given this and to promote smooth regulatory compliance actions, the requirements other than the RWA requirement should also be phase-in. Additionally, the LTD Minimum Requirement should also be subject to phase-in implementation because the LTD Minimum Requirement is imposed as a sub-component of the TLAC requirement and if the LTD minimum requirement is not phase-in, banks with sufficient Tier 1 would not in substance benefit from the mitigation measure.